BRIEF IN SUPPORT OF PETITION.

1. The Decision of the Circuit Court of Appeals Herein Is in Conflict With Decisions of Other Circuit Courts of Appeals.

The basic issue presented to the Court below was whether petitioner's securities designated 6½% Cumulative Preferred Serial Stock and 5½% Cumulative Preferred Serial Stock represented indebtedness of petitioner to the holders thereof and whether the so-called dividends paid to the holders of said securities were in fact interest payments on indebtedness within the meaning of Section 23(b) of the Revenue Act of 1936. From the opinion of the Circuit Court [R. 213] it appears that its decision that said securities did not represent indebtedness and that the payments were not interest was based upon the names used to describe the securities and the payments and upon the manner in which the securities were treated and the payments were made instead of upon the basic terms and conditions of the securities themselves.

The same question has been presented to other Circuit Courts of Appeals and to the Circuit Court of Appeals for the Ninth Circuit with regard to other securities and the courts have repeatedly stated that the true character of a security is to be determined from the terms and conditions of the contract between the parties and not from the names used by the parties to describe the securities or the payments made thereon.

Brown-Rogers-Dixson Co. v. Commissioner, (CCA-4, 1941) 122 F. (2d) 347;

Helvering v. Richmond F. & P. R. Co. (CCA-4, 1937), 90 F. (2d) 971;

Commissioner v. J. M. Bray Co. (CCA-5, 1942), 126 F. (2d) 612;

United States v. South Georgia Ry. Co. (CCA-5, 1939), 107 F. (2d) 3;

Commissioner v. Schmoll Fils Association, Inc. (CCA-2, 1940), 110 F. (2d) 611.

While each case has been decided upon its own facts, heretofore in each case the determining factor has been whether under the terms and conditions of the security or other contract the corporation had a definite and enforceable obligation to repay the principal sum and to pay a specified return on the investment, regardless of earnings or profits and on or before a definite date determined in advance.

Where such obligations existed it has been held that the security represented indebtedness and that the payments were interest, regardless of the names used.

Commissioner v. J. M. Bray Co. (supra);

Helvering v. Richmond F. & P. R. Co., (supra);

Commissioner v. O. P. P. Holding Co. (CCA-2, 1935) 76 F. (2d) 11;

Arthur R. Jones Syndicate v. Commissioner (CCA-7, 1927) 23 F. (2d) 833;

See also,

Commisisoner v. Palmer, Stacy-Merrill, Inc. (CCA-9, 1940) 111 F. (2d) 809;

Commissioner v. Proctor Shop, Inc. (CCA-9, 1936) 82 F. (2d) 792.

Where such obligations did not exist it has been held that the security did not represent indebtedness and that

the payments were not interest, regardless of the names used.

Commissioner v. Schmoll Fils Association, Inc. (supra);

Brown - Rogers - Dixson Co. v. Commissioner (supra);

United States v. South Georgia Ry. Co. (supra).

In the case at bar, under the specific terms of the securities petitioner had the liabilities and obligations which under the above stated rule establish a debtor-creditor relationship. Petitioner had an enforceable obligation to redeem the securities at the par value thereof on or before the specified maturity dates. [R. 153.] Petitioner also was required to pay the specified dividends (and no more) currently from earnings but from general assets, if necessary, on the specified maturity dates. [R. 153.] The only thing in petitioner's securities which was inconsistent with indebtedness was the names used. In the concurring opinion Judge Healy frankly states—"If they had been denominated 'bonds' rather than preferred stocks, I apprehend that nobody would contend that they were not true evidences of debt or that the returns paid thereon were anything other than interest." [R. 222.]

Judge Healy also states that he is unable to distinguish the present case on principle from *Commissioner v. Palmer, Stacy-Merrill, Inc.*, 111 F. (2d) 809 and *Commissioner v. Proctor Shop, Inc.*, 82 F. (2d) 792. [R. 221.] The decision in *Commissioner v. Proctor Shop, Inc. (supra)* was based primarily upon *Arthur R. Jones Syndicate v. Commissioner* (CCA-7, 1927) 23 F. (2d) 833. Judge Healy's statements indicate that he considered the decision to be a departure from the rule previously followed.

While the majority opinion does not specifically so state, it is apparent therefrom that the decision is based upon the names used and other incidental features and the manner in which the securities were treated, without regard to the basic terms and conditions of the securities.

It is respectfully submitted that the principle of the decision below is in direct conflict with the principle of the decisions of the other Circuit Courts of Appeals cited above.

The facts in the case at bar are quite similar to the facts in *Meridian & Thirteenth Realty Company v. Commissioner*, 44 B. T. A. 865, now pending on appeal before the Circuit Court of Appeals for the Seventh Circuit. In that case securities called stock were held to be indebtedness and payments called dividends were held to be interest. The terms of petitioner's securities, however, complied more strictly to the requirements of a debt in at least one respect than did the terms of the security in the *Meridian* case. Petitioner's securities provided for the enforcement of redemption and the payment of accumulated dividends upon maturity, the same as any unconditional claim or debt against the corporation, whereas in the *Meridian* case the holders of the securities could enforce redemption only by liquidation of the corporation. If the decision in that case is affirmed there will be a direct conflict between the two circuit courts upon almost identical facts.

In his brief on appeal in *Commissioner v. Meridian & Thirteenth Realty Company* (CCA-7, Docket # 7978) the Commissioner makes the following statement with regard to the two cases:

> "The Board itself has cast doubt upon its decision in the instant case, by its subsequent decision in *Pacific Southwest Realty Co. v. Commissioner*, 45 B. T.

A. 426, now pending on appeal before the Circuit Court of Appeals for the Ninth Circuit. In its opinion in that case, the Board attempted to distinguish its decision here. We submit, however, that the effort is not convincing. In fact, we think it will appear from the discussion to follow that there was greater warrant for finding an indebtedness in the *Pacific Realty* case than there was in the instant case."

Also, in the case of *United States v. Title Guarantee & Trust Co.*, now pending on appeal before the Circuit Court of Appeals for the Sixth Circuit, it appears from the opinion of the District Court that the facts are very similar to the facts in the case at bar. (*Title Guarantee & Trust Co. v. United States* (D. C. Ohio), June 25, 1941, Opinion reported in 1941 Prentice-Hall Federal Tax Service, Para. 62824; 1941 CCH Federal Tax Service, Para. 9597.) In that case the District Court held securities called preferred stock to be indebtedness and payments thereon called dividends to be interest. If that decision is affirmed on appeal there will be direct conflict with the decision of the Circuit Court herein.

Similar questions are also involved in appeals now pending before the Circuit Courts for the Fifth Circuit and the Third Circuit. *Parisian, Inc. v. Commissioner* (B. T. A. Memo. Op. Feb. 2, 1942) now pending on appeal before the Circuit Court of Appeals for the Fifth Circuit. *First Mortgage Corp. of Philadelphia v. Commissioner* (B. T. A. Memo Op. Mar. 12, 1942) now pending on appeal before the Circuit Court of Appeals for the Third Circuit.

Petitioner respectfully submits that the decision and opinion below create a conflict in principle with decisions of other Circuit Courts of Appeals which should be settled by this Court.

2. The Circuit Court of Appeals Has Decided an Important Question of Federal Tax Law Which Has Not Been But Should Be Settled by This Court.

Although the question of what constitutes indebtedness and interest on indebtedness within the meaning of Section 23(b) of the Internal Revenue Code and the corresponding sections of the prior Revenue Acts has been considered by the Board of Tax Appeals and the various federal courts on numerous occasions,* it has never been considered by this Court.

**Title Guarantee & Trust Co. v. United States* (D. C. Ohio, 1941), pending on appeal C.C.A. 6th;

Meridian & Thirteenth Realty Co. v. Commissioner, 44 B. T. A. 865, pending on appeal C.C.A. 7th;

Parisian, Inc. v. Commissioner, B. T. A. Memo, Feb. 2, 1942, pending on appeal C.C.A. 5th;

First Mortgage Corp. of Philadelphia v. Commissioner, B. T. A. Memo, Mar. 12, 1942, pending on appeal C.C.A. 3rd;

Commissioner v. J. M. Bray Co. (C.C.A. 5, 1942), 126 F. (2d) 612;

Brown-Rogers-Dixson Co. v. Commissioner (C.C.A. 4, 1941), 122 F. (2d) 347;

Commissioner v. Schmoll Fils Association, Inc. (C.C.A. 2, 1940), 110 F. (2d) 611;

Commissioner v. Palmer, Stacy-Merrill, Inc. (C.C.A. 9, 1940), 111 F. (2d) 809;

United States v. South Georgia Ry. Co. (C.C.A. 5, 1939), 107 F. (2d) 3;

Haffenreffer Brewing Co. v. Commissioner (C.C.A. 1, 1940), 116 F. (2d) 465;

Helvering v. Richmond F. & P. R. Co. (C.C.A. 4, 1937), 90 F. (2d) 971;

Commissioner v. Proctor Shop, Inc. (C.C.A. 9, 1936), 82 F. (2d) 792;

Commissioner v. O. P. P. Holding Co. (C.C.A. 2, 1936), 76 F. (2d) 11;

Arthur R. Jones Syndicate v. Commissioner (C.C.A. 7, 1927), 23 F. (2d) 833.

While most of the decisions have been based upon the terms and conditions of the securities in question or other contract between the parties, some of the decisions have been based upon evidence *aliunde* the contract with regard to the understanding and intention of the parties and in the present case the decision appears to be based upon the names used, the manner in which the securities and payments were treated and an opinion of counsel. No clear and definite rule can be formulated from the decided cases for the determination of whether or not a particular security represents indebtedness and whether particular payments are interest or dividends.

State laws with regard to corporations and corporate securities have been so liberalized and so many securities now issued by corporations have features which are consistent with either stock or indebtedness that it is often difficult to definitely classify a particular security as being a stock or a debt.

The determination of whether a security is a stock or a debt and whether the payments thereon are dividends or interest within the meaning of the federal revenue laws is of great importance, both to the taxpayers in properly preparing their returns and computing their tax liability and to the government in properly administering the tax laws. While most of the decided cases have involved the application of Section 23(b) of the Internal Revenue Code and the corresponding sections of earlier Revenue Acts, the question is also of importance in the administration of

other sections of the law, such as Sections 23(k), 112(b)(2) and 719 of the Internal Revenue Code. Until this Court interprets Section 23(b) of the Internal Revenue Code and determines whether the true nature of a security is to be determined from the names used or from the basic terms and conditions of the securities, it is inevitable that there will be continuous controversy and litigation.

The existing confusion with regard to this question is well illustrated by a comparison of the present case with some of the other decided cases. The facts in the case at bar are identical in all material respects with the facts in three other cases, namely, *Meridian & Thirteenth Realty Company v. Commissioner,* 44 B. T. A. 865 (pending on appeal C. C. A. 7th); *Title Guarantee & Trust Co. v. United States* (D. C. Ohio), June 25, 1941, opinion reported in 1941 Prentice-Hall Federal Tax Service, para. 62824; 1941 C. C. H. Federal Tax Service, para. 9597, (pending on appeal C. C. A. 6th); *Diamond Calk Horse Shoe Co. v. United States* (D. C. Minn., July 19, 1940); opinion reported 1940 Prentice-Hall Federal Tax Service, para. 62919, and 1940 C. C. H. Federal Tax Service, para. 9641 (appeal dismissed—C. C. A. 8, 116 F. (2d) 284). In the mentioned cases the Board and the District Courts held securities called stock to be indebtedness and payments thereon called dividends to be interest payments primarily on the ground that the securities carried a definite obligation to repay the principal sum and the fixed dividends on or before a specified maturity date.

In view of the importance to the proper administration of the federal revenue laws of the question of what constitutes indebtedness and interest paid on indebtedness within the meaning of Section 23(b) and other sections of the Internal Revenue Code, and the further question of what are the essential features of an indebtedness, it is respectfully submitted that the present case involves important questions of federal law which have not been but should be settled by this Court.

It is respectfully submitted that this petition should be granted.

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Of Counsel:
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August, 1942.

Due service of the within petition and brief is hereby acknowledged this.....day of August, A. D. 1942.

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Counsel for Respondent.

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